

# Spectra Energy Corp SE (NYSE) ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Solid investment opportunities at Spectra Energy provide a strong platform for growth.

Updated Forecasts and Estimates from 12 Mar 2015

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### Investment Thesis 12 Mar 2015

Spectra is a pure play on natural gas demand and infrastructure. Its operations stretch across all links in the natural gas value chain, with the exception of riskier exploration and production. With positions in gathering, processing, transportation, storage, and distribution, Spectra collects a large portion of the economic rents paid to move gas to end users.

About a third of Spectra's earnings, depending on commodity prices, come from gathering and processing natural gas. The bulk of gathering-processing cash flows come from Spectra's 50% ownership of DCP Midstream, a joint venture with Phillips 66. While there is significant commodity exposure here, Spectra explicitly discounts earnings from this JV when planning dividends, instead using cash from the JV to offset capital spending needs when DCP Midstream benefits from attractive processing margins. We think the inclusion of this business in Spectra's financials creates the appearance of greater cash flow volatility than the company's core assets warrant.

In our eyes, Spectra's most attractive business is its U.S. transmission segment, long-haul pipelines, and storage facilities that move about 12% of gas consumed in North America. Nearly half of the company's earnings stem from stable, long-term contracts for firm capacity across this system. Canadian distribution subsidiary Union Gas makes up the balance of Spectra's earnings and supplies natural gas to 1.3 million customers in Ontario. Earnings fluctuate somewhat with the weather, as the primary uses for natural gas are winter heating and, increasingly, summer cooling.

Growth opportunities for Spectra remain compelling, thanks to its large, diverse, and well-positioned asset base. Pipelines and fee-based processing opportunities in the U.S. and Canada offer low-risk, bite-size, bolt-on growth opportunities backed by firm contracts. Overall, Spectra and DCP are currently executing on \$7.5 billion in approved projects that will enter service through 2019. More than \$20 billion in additional identified projects will ensure longer-term growth prospects.

The primary analyst covering this company does not own its stock.

Research as of 12 Mar 2015  
Estimates as of 12 Mar 2015  
Pricing data through 19 Mar 2015  
Rating updated as of 19 Mar 2015

Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.

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### Vital Statistics

Market Cap (USD Mil)	23,589
52-Week High (USD)	43.12
52-Week Low (USD)	32.43
52-Week Total Return %	0.2
YTD Total Return %	-2.2
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	7.2
5-Yr Forward EPS CAGR %	6.7
Price/Fair Value	0.76

### Valuation Summary and Forecasts

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Price/Earnings		23.0	22.5	28.1	24.4
EV/EBITDA		12.7	12.3	13.8	12.5
EV/EBIT		17.2	16.6	19.4	17.6
Free Cash Flow Yield %		0.4	0.8	-1.3	-1.5
Dividend Yield %		3.4	3.8	4.2	4.6

### Financial Summary and Forecasts (USD Mil)

	Fiscal Year:	2013	2014	2015(E)	2016(E)
Revenue		5,518	5,903	6,277	6,623
Revenue YoY %		8.7	7.0	6.3	5.5
EBIT		2,235	2,344	1,962	2,160
EBIT YoY %		9.7	4.9	-16.3	10.1
Net Income, Adjusted		1,038	1,082	838	966
Net Income YoY %		10.6	4.3	-22.6	15.3
Diluted EPS		1.55	1.61	1.25	1.44
Diluted EPS YoY %		8.1	4.1	-22.7	15.3
Free Cash Flow		-844	1,324	116	34
Free Cash Flow YoY %		121.4	-256.7	-91.2	-71.2

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

### Profile

Spectra Energy is one of the largest natural gas midstream companies in North America. Its operations span the entire value chain, from wellhead to burner tip. Spectra's assets include more than 19,000 miles of transmission pipelines and roughly 7% of U.S. natural gas storage capacity. Spectra owns 50% of DCP Midstream, a joint venture with Phillips 66, as well as being the general partner with a majority limited partner stake in Spectra Energy Partners.

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## Morningstar Analysis

### Revisiting Estimates for Spectra Energy in a Lower Commodity Price Environment 12 Mar 2015

Our fair value estimates for Spectra Energy and Spectra Energy Partners (SEP) have increased modestly to \$46 per share from \$44 for Spectra Energy and to \$63 from \$62 for SEP, despite of our review of long-term midcycle oil and gas price assumptions. Our long-term oil price expectation has decreased from \$100 to \$75 Brent, and our long-term U.S. gas price forecast is now \$4 versus \$5.40 per thousand cubic feet. As a result of the recent commodity price pullback, we expect significant services price cuts and reduced activity, likely throughout 2016. Over the longer term, however, we now see North America as the leading source of oil supply growth over the coming years, at the expense of oil sands and deep-water offshore projects. Despite lower current prices and our reduced long-term midcycle price assumptions, we forecast rising oil and gas production levels in the U.S. as upstream producers benefit from improved drilling economics. Rising production will require additional infrastructure spending, providing a clear path for continued midstream growth over the coming years.

For Spectra, the obvious casualty of lower commodity prices is its gathering and processing business. As a 50% owner of DCP Midstream, Spectra has received \$1.8 billion in cash distributions since 2007, averaging \$230 million a year. Given current commodity prices, processing margins are no longer robust and Spectra has explicitly zeroed out contributions from this business through 2017. Accounting for this reduced our fair value estimate by approximately \$3 per share, but a slight reduction in our cost of equity assumption offset this decrease. Our expectations for fee-based cash flow growth at SEP led to the slight fair value increase for both firms, as SEP will account for 70% of Spectra's EBITDA growth through 2017. We continue to see both firms as solid, wide-moat franchises trading at appealing discounts to our fair value estimates.

### Valuation, Growth and Profitability 12 Mar 2015

Our fair value estimate for Spectra Energy is \$46 per share, up modestly from \$44 per share. This implies an enterprise value/EBITDA ratio of 17 times and a forward yield of 3%.

We expect 2015 adjusted EBITDA of \$2.8 billion and 2016 adjusted EBITDA of \$3.0 billion. Spectra Energy Partners is the largest source of growth for Spectra, accounting for 70% of planned EBITDA growth through 2017. Spectra has explicitly zeroed out contributions from commodity-sensitive DCP Midstream; should oil prices recover, any excess cash generation from this business will be used to help fund growth capital expenditures. We think Spectra is on track to increase dividends per share to \$1.76 in 2017, from \$1.48 this year, though dividend coverage is dropping to only 1 times, much tighter than we're accustomed to seeing from this company. We expect capex of \$2.5 billion-\$3.0 billion through 2019.

We discount cash flows using a 7.5% cost of equity assumption, which results in a 7.0% weighted average cost of capital. We check our discounted cash flow valuation with a dividend discount model, which values Spectra at \$43.

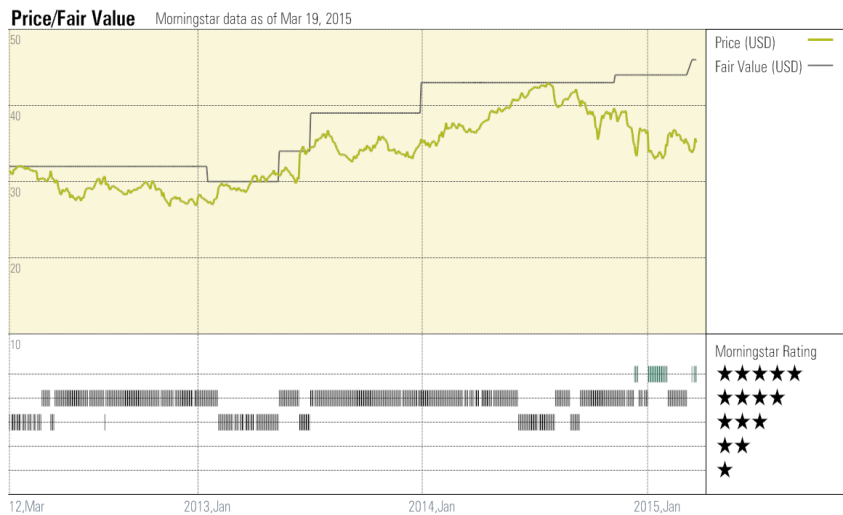
### Scenario Analysis

For scenario analysis, we use differing return on new invested capital and earnings growth assumptions to kick off our second stage of our three-stage discounted cash flow model and differing second-stage and terminal distribution growth assumptions to drive our dividend discount model.

In our base case, we assume that Spectra will earn 12% on new invested capital and will be able to increase earnings at around 8%. Our dividend discount model assumes 7.8% growth through 2019, 6.5% growth through 2024, and 3% thereafter. This scenario values Spectra at \$46 per share, for an enterprise value of \$47 billion, implying a 17 times

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markets. Its core strategy is to own and operate natural gas assets with local monopolies, effectively maximizing switching costs and yielding consistently attractive returns on invested capital. We think each of Spectra's various businesses has a moat, though we believe that Union Gas only deserves a narrow moat, given its limited ability to increase regulated returns. We're particularly interested in Spectra's pipeline assets, which consist of long-haul interstate pipelines that run from the Gulf Coast to Midwest, Northeast, and Florida markets and from northeastern British Columbia to Vancouver. Spectra's strong positions in the Marcellus, Horn River, and Montney shale plays provide particularly attractive long-term growth opportunities. As Spectra continues to devote most of its growth capital to a variety of internal pipeline and storage projects, we think it can achieve economies of scale by flowing incremental volumes through its existing system, connecting North America's major natural gas resource plays with its prominent demand centers.

multiple of 2015 EBITDA.

Our bull case ramps up both of these assumptions, with 14% returns on new invested capital and 9% earnings growth. Our dividend discount model assumes 7.8% growth through 2019, 8.5% growth through 2024, and 4% thereafter. In this scenario we think Spectra would be worth \$61 per share. That results in an enterprise value of \$59 billion, implying a 21 times multiple of 2015 EBITDA.

Our bear case dials down both factors, with 10% assumed returns on new invested capital and 7% earnings growth. Our dividend discount model assumes 7.8% growth through 2019, 4.5% growth through 2024, and 2% thereafter. Here Spectra would be worth \$37 per share for an enterprise value of \$41 billion, implying a 15 times multiple of 2015 EBITDA.

### Economic Moat

We think Spectra Energy has a wide economic moat. As one of the largest natural gas transportation and distribution companies in North America, Spectra can bring its impressive scale and experience to bear across multiple

### Moat Trend

We believe Spectra's wide moat is stable. One reason we think the company will continue to deliver returns that exceed its cost of capital is that its core pipelines and distribution businesses offer attractive regulated rates of return. Another reason is the Federal Energy Regulatory Commission, which won't approve competing projects without a demonstrated economic need, giving Spectra protection from competitors. Spectra's extensive and well-positioned pipeline network connects many of North America's top-producing natural gas plays with top demand centers, which diversifies cash flows and creates economies of scale. We expect Spectra will invest around \$3 billion or more per year in the next couple of years toward an array of attractive low-risk bolt-on growth projects. Most of these projects are lateral pipeline extensions or storage additions that enhance the value of Spectra's entire footprint, such as the TEAM 2014 extension to the Texas Eastern system in the Marcellus. All of the projects will add

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attractive fee-based cash flows, and firm contracts maximize the chances that Spectra will continue to achieve returns on invested capital above its cost of capital. While we expect Spectra to generate positive economic profits in virtually any commodity price environment, Spectra's interest in DCP Midstream provides substantial upside to overall returns in the case of rising commodity prices.

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## Bulls Say/Bears Say

### Bulls Say

- ▶ Spectra Energy is an 800-pound gorilla of the natural gas midstream business. Its size, market knowledge, and customer relationships give it an edge when developing new projects.
- ▶ The drop-down of UST to Spectra Energy Partners accelerated value recognition and will allow Spectra to fund future growth more efficiently.
- ▶ Access to developing shale plays--particularly the Marcellus, Horn River, and Montney--provides Spectra with compelling, visible growth opportunities.

### Bears Say

- ▶ Higher costs of capital may change the types of projects Spectra can pursue, although so far the company has retained access to favorably priced capital.
- ▶ The flip side to outsize cash flows from DCP Midstream in recent years is weak cash flows--and skittish shareholders--when commodity prices are falling.
- ▶ Because of its size, Spectra has to spend a lot in order to move the needle. While Spectra has another \$20 billion in identified projects, at some point it may become more difficult to put capital to work on attractive projects, and returns may begin to slip.

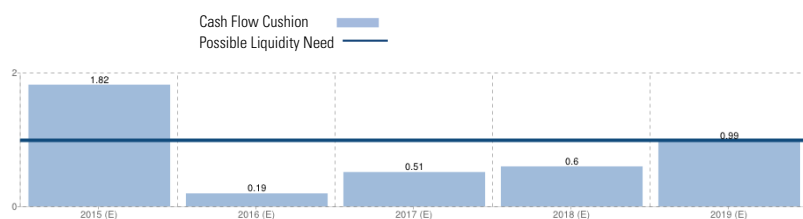
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## Five Year Adjusted Cash Flow Forecast (USD Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	215	701	672	815	1,119
Adjusted Available Cash Flow	2,743	-333	-127	74	190
Total Cash Available before Debt Service	2,958	368	544	889	1,308
Principal Payments	-921	-1,195	-342	-760	-588
Interest Payments	-705	-710	-720	-730	-740
Other Cash Obligations and Commitments	—	—	—	—	—
Total Cash Obligations and Commitments	-1,626	-1,905	-1,062	-1,490	-1,328

## Cumulative Annual Cash Flow Cushion



## Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	215	2.9
Sum of 5-Year Adjusted Free Cash Flow	2,546	34.4
Sum of Cash and 5-Year Cash Generation	2,761	37.3
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	2,761	37.3
Sum of 5-Year Cash Commitments	-7,411	—

## Financial Health

Spectra Energy is a healthy business that throws off copious cash flow. Although it regularly carries a high proportion of debt/total capital--in the 55%-65% range--the company can easily cover its debt payments. EBITDA has covered interest by more than 4 times every year since its IPO, and debt/EBITDA stands north of 4 times as well. We expect future growth to be financed efficiently by using Spectra Energy Partners and DCP Midstream Partners to raise equity capital. We expect Spectra to spend about \$3 billion a year on growth projects and to fund these with debt, operating cash flow, and cash from its GP and LP stakes in SEP. Notably, with all of its U.S. gas and liquids pipelines now held by SEP, we expect to see Spectra make greater use of the master limited partnership for raising capital, decreasing the parent company's financing burden. Spectra plans to boost its dividend by \$0.12 per share a year after its 2013 drop-down of its U.S. Transmission assets, implying 7.5% average annual dividend growth.

## Enterprise Risk

While roughly 88% of cash flows are fee-based, low commodity prices destroy margins for the remaining 12%, and a sustained low-price environment could stunt growth across the board by keeping producer drilling at bay. Through DCP, Spectra is exposed to the spread in natural gas liquids and natural gas prices; as natural gas prices increase, while NGL prices decline, processing margins at DCP deteriorate, reducing cash available for distribution to Spectra. We worry somewhat about access to capital in the event of a market collapse and note that rising interest rates could raise costs of refinancing debt and send investors into other yield vehicles. Other risks include changes to regulatory safety requirements, environmental exposures, leaks, spills, or fires.

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## Management & Ownership

### Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
GREGORY L. EBEL	Director/CEO/President/Chairman of the Board, Director	226,497	21 Feb 2015	—
DOROTHY M. ABLES	Chief Administrative Officer	144,104	21 Feb 2015	—
REGINALD D. HEDGEBETH	General Counsel	114,128	21 Feb 2015	—
MR. MICHAEL E. J. PHELPS	Director	80,558	31 Dec 2014	—
MR. JOHN (PAT) PATRICK REDDY	CFO	73,773	21 Feb 2015	—
WILLIAM (BILL) T. YARDLEY	President, Divisional	51,156	21 Feb 2015	—
AUSTIN A. ADAMS	Director	43,745	01 Jul 2014	—
MR. PETER B. HAMILTON	Director	31,374	01 Jul 2014	—

\*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

### Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
VA CollegeAmerica Income Fund of America	3.50	0.93	—	31 Dec 2014
Vanguard Total Stock Mkt Idx	1.72	0.10	262	31 Jan 2015
VA CollegeAmerica American Mutual	1.50	1.04	6,393	31 Dec 2014
Franklin Income Fund	1.49	0.39	—	31 Dec 2014
Energy Select Sector SPDR® Fund	1.08	2.07	85	18 Mar 2015
<b>Concentrated Holders</b>				
Tortoise VIP MLP & Pipeline Portfolio	—	8.64	1	30 Nov 2014
Tortoise MLP & Pipeline Fund	0.66	8.57	-142	30 Nov 2014
Castle Focus Fund	0.04	7.11	170	31 Dec 2014
Global X MLP & Energy Infrastructure ETF	0.05	6.90	—	18 Mar 2015
GS NA Shale Revolution&Engy Infra Port	0.11	5.97	-20	31 Jan 2015

### Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/Sold (k)	Portfolio Date
Duke Energy Corporation Retirement Savings Plan	2.57	18.15	16,273	31 Dec 2007
Capital Research Global Investors	3.54	0.30	10,862	31 Dec 2014
State Street Global Advisors (Aus) Ltd	0.89	0.13	7,026	17 Mar 2015
Government Pension Fund of Norway - Global	0.67	0.02	3,754	31 Dec 2013
State Street Corp	4.84	0.12	2,604	31 Dec 2014
<b>Top 5 Sellers</b>				
BB&T SECURITIES, LLC	0.22	1.23	-12,546	31 Dec 2014
Merrill Lynch & Co Inc	0.80	0.11	-4,879	31 Dec 2014
T. Rowe Price Associates, Inc.	1.05	0.05	-3,655	31 Dec 2014
Brookfield Asset Management Inc	0.51	0.60	-3,579	31 Dec 2014
Deutsche Asset Mgmt Invst Gesenschaft	1.85	1.21	-2,564	31 Dec 2014

### Management 12 Mar 2015

Spectra Energy runs a tight ship and is managed by longtime industry hands. Greg Ebel is chairman, president, and CEO and has held a number of leadership roles in the company. Spectra's board is packed with independent directors; only Ebel is employed by Spectra. Compensation seems reasonable for a company of this size, and the management team's incentive plans stress long-term returns. Overall, we think Spectra Energy is a company with exemplary management that looks out for the interests of its owners. The decision to accelerate drop-downs to Spectra Energy Partners is a good example of this. While the company had outlined a plan to shift \$2 billion in assets to SEP through drop-downs in early 2013, the U.S. Transmission drop-down moved Spectra toward an energy infrastructure holding company structure, something that has worked out well for firms such as Williams and Kinder Morgan. We think this decision will result in more rapid dividend growth for Spectra and underscores the value of its midstream franchise.

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For Spectra, the obvious casualty of lower commodity prices is its gathering and processing business. As a 50% owner of DCP Midstream, Spectra has received \$1.8 billion in cash distributions since 2007, averaging \$230 million a year. Given current commodity prices, processing margins are no longer robust and Spectra has explicitly zeroed out contributions from this business through 2017. Accounting for this reduced our fair value estimate by approximately \$3 per share, but a slight reduction in our cost of equity assumption offset this decrease. Our expectations for fee-based cash flow growth at SEP led to the slight fair value increase for both firms, as SEP will account for 70% of Spectra's EBITDA growth through 2017. We continue to see both firms as solid, wide-moat franchises trading at appealing discounts to our fair value estimates.

### Energy Sector Coverage Under Review Pending Oil and Gas Pricing Updates 06 Mar 2015

We are placing our energy sector coverage under review as we prepare to update our long-term global oil and U.S. natural gas pricing outlooks. We expect to reduce our price forecast in each instance, with publication by March 13. In general, our lower midcycle price decks will have a negative impact on our fair value estimates, although the magnitude will vary by company and subsector (integrateds, exploration and production firms, services, midstream, and refiners).

We expect to lower our midcycle price estimate for U.S. natural gas from its previous level of \$5.40 per thousand cubic feet as a result of three factors: services cost deflation driven by oil price declines, continued production growth in low-cost areas like the Marcellus Shale, and ongoing efficiency gains in higher-cost areas. Our natural gas price forecast is based on a bottom-up analysis of well economics across the dozen or so major producing areas in the United States, our expectation of rig activity, and our projection of future gas consumption. Despite meaningful demand tailwinds--our forecast calls for U.S. natural gas demand to grow more than 25% through 2020--we believe sufficient low-cost natural gas exist to meet these elevated demand levels at prices below our previous midcycle estimate.

With respect to our long-term oil price outlook, the fundamental issue that has changed relative to our previous midcycle per-barrel estimates (\$100 Brent and \$90 West Texas Intermediate) is the emergence of U.S. tight oil. Although U.S. production is showing in real time that quick supply responses are possible, any near-term slowdown--we project U.S. crude oil production will begin declining over the next quarter or two--does nothing to diminish the resource potential that is in place. Given our belief that oil prices will increase from current levels, near-term declines



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in output will be short-lived and are likely to quickly reverse as producers respond to price signals.

As such, we believe the dynamic of U.S. tight oil being able to meet a large portion of incremental global oil supply needs is far from over. The implication is that the highest points on the global cost curve have effectively been crowded out and additional projects from these areas won't be needed until next decade. Of course, U.S. tight oil alone can't meet future global supply needs over the next several years, so the marginal barrel will necessarily be produced from a higher-cost resource. We expect that higher-quality deep-water projects will serve as the marginal barrel when our midcycle forecast kicks in over 2018-20.

### **Access Northeast Pipeline Project One Step Closer to Reality With National Grid Sign-On** 18 Feb 2015

We are reaffirming our fair value estimates and moat and moat trend ratings for National Grid, Eversource Energy, and Spectra Energy after National Grid announced that it will join the proposed Access Northeast pipeline project as a co-developer. With the project completion date not until the end of 2018 and remaining uncertainties, we continue to exclude the project from our near-term financial forecasts. However, it is a project that has wide-moat characteristics and supports our moat ratings.

We think National Grid's partnership could be the move that gets the project over a key initial hurdle. We expect the \$3 billion project to be value-accretive for all three participants, but it likely is not a big enough investment for any of the companies relative to their sizes to have material impacts on our fair value estimates.

The project's open season through May is another key gating factor that will determine the economics of the pipeline. We're particularly interested in whether power generators participate. The Northeast transmission grid operator has estimated that the region will need 1.1 billion cubic feet per

day of incremental gas supply by 2020, but generators typically are hesitant to pay for firm supply without assurance they will run. We think capacity contracts could support firm gas supply, particularly for new-build projects we estimate could draw about 156 million cubic feet of gas demand per day. It's also possible Repsol will show interest in firm capacity to supply a potential liquefied natural gas export facility.

If the open season is successful and the project moves forward, the next step will be securing all of the local, state, and federal permits. If the project can secure Federal Energy Regulatory Commission approval in 2016-17, we expect that we will have enough firm cost and revenue projections to include it in our forecasts and valuations.

### **Spectra and SEP Meet Expectations in 4Q; Cash Flow Will Remain Steady Despite Oil Price Collapse** 03 Feb 2015

Spectra Energy and Spectra Energy Partners delivered another strong quarter, on par with expectations. We are maintaining our fair value estimates and wide moat ratings for both firms at this time.

Spectra Energy Partners' core U.S. Transmission business reported EBITDA of \$369 million for the quarter, up 15% from \$322 million last year and just above our estimate of \$360 million. The liquids segment posted \$71 million in EBITDA, up from \$41 million a year ago. Total distributable cash flow for the quarter came in at \$245 million, or \$0.84 per unit, providing 1.42 times coverage of the declared \$0.58875 per unit distribution.

Spectra Energy posted quarterly net income of \$316 million, or \$0.47 per share, up from last year's \$236 million, in part thanks to lower taxes due to shifting the U.S. Transmission assets into Spectra Energy Partners. EBITDA for the quarter

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came in at \$810 million, putting full-year EBITDA at \$3.1 billion, in line with our estimates. While Field Services is seeing weakness due to lower commodity prices, recall that what matters to Spectra (as 50% owner) is cash distributions received, not subsidiary earnings. And cash distributions from the DCP joint venture cannot drop below zero. Thus while Spectra is likely to record some commodity-related volatility in its 2015 consolidated financials, the actual downside for Spectra's cash flow here is limited, and its dividend growth remains on track.

Spectra is hosting an analyst day on Feb. 5 and will elaborate on its 2015 plans, but at this juncture we think new projects entering service will support another solid year for both firms.

#### **OPEC Inaction Tanks Oil Prices and Energy Stocks, but Midstream Cash Flows Remain Robust** 01 Dec 2014

Midstream stocks are selling off in the aftermath of OPEC's Thanksgiving Day decision to maintain existing production quotas, dashing the market's hope that OPEC would step in and remove excess crude oil supply from the market. By our estimates, oil markets are oversupplied by roughly 1 million barrels a day, which may increase into early 2015 absent a production response. We think that the market's reaction is overdone, particularly if you consider that 1 million to 2 million barrels a day of excess supply is equivalent to 1.1% to 2.2% of daily consumption, and depletion alone removes roughly 4% of total production each year. Moreover, the supply surge from U.S. shale oil has been well anticipated by markets, leaving us to wonder what has changed fundamentally in the market's awareness that has dropped the energy sector as a whole by 20% since September 1. We suggest investors pay attention to oil demand, as any further weakness could spark another leg down in oil markets. That said, over the medium term we'd expect lower crude prices to stimulate demand, supporting our

expectation of higher prices in the future.

We think the market reaction among midstream firms in particular has been overdone. While some U.S. MLPs do have modest direct crude oil or natural gas liquids price exposure, the vast majority of cash flows are linked to long-term, fee-based contracts, supporting relatively stable cash flows despite market tumult. Moreover, midstream firms create value by building new assets. Despite low oil prices, we continue to see robust project pipelines from firms in our coverage.

We view the current pullback in stock prices as a good opportunity to buy quality franchises at a discount. Wide moat MLPs such as ONEOK Partners, Williams Partners, and Enterprise Products Partners look compelling currently, as do large-cap midstream corporations Spectra Energy, Williams, and Enbridge.

#### **3Q In Line for Wide-Moat Spectra and SEP; Increasing Spectra's Fair Value by \$1 to \$44** 10 Nov 2014

Spectra Energy and Spectra Energy Partners delivered strong third-quarter earnings, on par with expectations. While we're not making any changes at this time to our fair value estimate for Spectra Energy Partners (which we raised just before earnings), we are increasing our fair value for Spectra Energy by \$1 to \$44 per share, largely in recognition of a faster-than-anticipated dividend hike. Our wide moat ratings for both firms are intact.

Spectra Energy Partners' core U.S. Transmission business reported EBITDA of \$352 million for the quarter, up 11% from \$318 million last year. The liquids segment posted \$60 million in EBITDA, up from \$40 million a year ago. Total distributable cash flow for the quarter came in at \$247 million, or \$0.84 per unit, providing 1.46 times coverage of the declared \$0.57625 per unit distribution.

# Spectra Energy Corp SE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Analyst Notes

Spectra Energy posted quarterly net income of \$201 million, or \$0.30 per share, down from last year's \$263 million. Relative weakness at field services was the primary culprit, though a weaker Canadian dollar also contributed. EBITDA only decreased 6% year over year, and we continue to expect full-year EBITDA of \$3.1 billion.

During the quarter, Spectra added four new projects to its list, worth \$700 million. Year to date, Spectra has moved more than \$3 billion of projects into execution, a pace we expect it to keep up for the foreseeable future.

# Spectra Energy Corp SE (NYSE) ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Morningstar Analyst Forecasts

### Financial Summary and Forecasts

Fiscal Year Ends in December

	3-Year Hist. CAGR	Forecast					5-Year Proj. CAGR
		2012	2013	2014	2015	2016	
Growth (% YoY)							
Revenue	3.3	-5.2	8.7	7.0	6.3	5.5	7.2
EBIT	-0.2	-13.7	9.7	4.9	-16.3	10.1	5.0
EBITDA	0.7	-9.3	8.0	4.3	-12.4	10.0	5.7
Net Income	-2.8	-20.3	10.6	4.3	-22.6	15.3	6.7
Diluted EPS	-3.7	-20.7	8.1	4.1	-22.7	15.3	6.7
Earnings Before Interest, after Tax	0.9	-21.5	18.5	10.6	-8.4	9.4	5.8
Free Cash Flow	44.3	-186.6	121.4	-256.7	-91.2	-71.2	-11.9

	3-Year Hist. Avg						5-Year Proj. Avg
		2012	2013	2014	2015	2016	
Profitability							
Operating Margin %	40.1	40.2	40.5	39.7	31.3	32.6	33.9
EBITDA Margin %	54.4	55.1	54.8	53.4	44.0	45.9	47.4
Net Margin %	18.6	18.5	18.8	18.3	13.4	14.6	15.8
Free Cash Flow Margin %	-0.1	-7.5	-15.3	22.4	1.9	0.5	4.5
ROIC %	—	—	—	—	—	—	—
Adjusted ROIC %	9.7	8.0	10.1	11.0	8.9	9.2	10.2
Return on Assets %	3.2	3.2	3.2	3.2	2.4	2.6	2.9
Return on Equity %	12.0	11.0	11.9	13.0	8.8	8.4	9.3

	3-Year Hist. Avg						5-Year Proj. Avg
		2012	2013	2014	2015	2016	
Leverage							
Debt/Capital	0.61	0.59	0.62	0.64	0.55	0.54	0.53
Total Debt/EBITDA	4.56	4.59	4.53	4.55	4.80	4.55	4.25
EBITDA/Interest Expense	4.57	4.48	4.60	4.64	3.92	4.28	4.74

### Valuation Summary and Forecasts

	2013	2014	2015(E)	2016(E)
Price/Fair Value	0.83	0.83	—	—
Price/Earnings	23.0	22.5	28.1	24.4
EV/EBITDA	12.7	12.3	13.8	12.5
EV/EBIT	17.2	16.6	19.4	17.6
Free Cash Flow Yield %	0.4	0.8	-1.3	-1.5
Dividend Yield %	3.4	3.8	4.2	4.6

### Key Valuation Drivers

Cost of Equity %	7.5
Pre-Tax Cost of Debt %	6.5
Weighted Average Cost of Capital %	7.0
Long-Run Tax Rate %	12.0
Stage II EBI Growth Rate %	8.0
Stage II Investment Rate %	66.7
Perpetuity Year	20

Additional estimates and scenarios available for download at <http://select.morningstar.com>.

### Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	1,332	2.9	1.76
Present Value Stage II	10,269	22.6	13.59
Present Value Stage III	33,907	74.5	44.87
<b>Total Firm Value</b>	<b>45,507</b>	<b>100.0</b>	<b>60.22</b>
Cash and Equivalents	215	—	0.28
Debt	-14,352	—	-18.99
Preferred Stock	—	—	—
Other Adjustments	3,000	—	3.97
<b>Equity Value</b>	<b>34,370</b>	<b>—</b>	<b>45.48</b>

Projected Diluted Shares 756

Fair Value per Share (USD) —

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

# Spectra Energy Corp SE (NYSE) ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Morningstar Analyst Forecasts

### Income Statement (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
<b>Revenue</b>	<b>5,075</b>	<b>5,518</b>	<b>5,903</b>	<b>6,277</b>	<b>6,623</b>
Cost of Goods Sold	2,756	3,080	3,179	3,580	3,917
<b>Gross Profit</b>	<b>2,319</b>	<b>2,438</b>	<b>2,724</b>	<b>2,696</b>	<b>2,705</b>
Selling, General & Administrative Expenses	—	—	—	—	—
Other Operating Expense (Income)	—	—	—	—	—
Other Operating Expense (Income)	-465	-569	-420	-146	-422
Depreciation & Amortization (if reported separately)	746	772	800	880	968
<b>Operating Income (ex charges)</b>	<b>2,038</b>	<b>2,235</b>	<b>2,344</b>	<b>1,962</b>	<b>2,160</b>
Restructuring & Other Cash Charges	-2	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
<b>Operating Income (incl charges)</b>	<b>2,040</b>	<b>2,235</b>	<b>2,344</b>	<b>1,962</b>	<b>2,160</b>
Interest Expense	625	657	679	705	710
Interest Income	—	—	—	—	—
<b>Pre-Tax Income</b>	<b>1,415</b>	<b>1,578</b>	<b>1,665</b>	<b>1,257</b>	<b>1,450</b>
Income Tax Expense	370	419	382	289	333
Other After-Tax Cash Gains (Losses)	2	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	-107	-121	-201	-130	-150
(Preferred Dividends)	—	—	—	—	—
<b>Net Income</b>	<b>940</b>	<b>1,038</b>	<b>1,082</b>	<b>838</b>	<b>966</b>
Weighted Average Diluted Shares Outstanding	656	671	672	673	673
<b>Diluted Earnings Per Share</b>	<b>1.43</b>	<b>1.55</b>	<b>1.61</b>	<b>1.25</b>	<b>1.44</b>
Adjusted Net Income	939	1,038	1,082	838	966
<b>Diluted Earnings Per Share (Adjusted)</b>	<b>1.43</b>	<b>1.55</b>	<b>1.61</b>	<b>1.25</b>	<b>1.44</b>
Dividends Per Common Share	1.15	1.22	1.38	1.48	1.60
<b>EBITDA</b>	<b>2,800</b>	<b>3,022</b>	<b>3,153</b>	<b>2,762</b>	<b>3,040</b>
<b>Adjusted EBITDA</b>	<b>2,798</b>	<b>3,022</b>	<b>3,153</b>	<b>2,762</b>	<b>3,040</b>

# Spectra Energy Corp SE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Morningstar Analyst Forecasts

### Balance Sheet (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Cash and Equivalents	94	201	215	701	672
Investments	—	—	—	—	—
Accounts Receivable	970	1,336	1,336	1,421	1,499
Inventory	309	263	313	353	386
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	290	281	468	468	468
<b>Current Assets</b>	<b>1,663</b>	<b>2,081</b>	<b>2,332</b>	<b>2,943</b>	<b>3,024</b>
Net Property Plant, and Equipment	19,905	21,829	22,307	23,967	25,887
Goodwill	—	—	4,714	4,714	4,714
Other Intangibles	4,513	4,810	—	—	—
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	4,506	4,813	4,687	4,687	4,687
Long-Term Non-Operating Assets	—	—	—	—	—
<b>Total Assets</b>	<b>30,587</b>	<b>33,533</b>	<b>34,040</b>	<b>36,311</b>	<b>38,312</b>
Accounts Payable	464	440	458	516	564
Short-Term Debt	2,180	1,197	1,583	—	—
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	1,147	2,402	1,768	1,768	1,768
<b>Current Liabilities</b>	<b>3,791</b>	<b>4,039</b>	<b>3,809</b>	<b>2,284</b>	<b>2,332</b>
Long-Term Debt	10,653	12,488	12,769	13,261	13,821
Deferred Tax Liabilities (Long-Term)	4,358	4,968	5,405	5,867	6,371
Other Long-Term Operating Liabilities	1,684	1,457	1,401	1,401	1,401
Long-Term Non-Operating Liabilities	—	—	—	—	—
<b>Total Liabilities</b>	<b>20,486</b>	<b>22,952</b>	<b>23,384</b>	<b>22,813</b>	<b>23,925</b>
Preferred Stock	—	—	—	—	—
Common Stock	1	1	1	1	1
Additional Paid-in Capital	5,297	4,869	4,956	7,956	8,956
Retained Earnings (Deficit)	2,165	2,383	2,541	2,383	2,272
(Treasury Stock)	—	—	—	—	—
Other Equity	1,509	1,241	662	662	662
<b>Shareholder's Equity</b>	<b>8,972</b>	<b>8,494</b>	<b>8,160</b>	<b>11,002</b>	<b>11,891</b>
Minority Interest	1,129	2,087	2,496	2,496	2,496
<b>Total Equity</b>	<b>10,101</b>	<b>10,581</b>	<b>10,656</b>	<b>13,498</b>	<b>14,387</b>

# Spectra Energy Corp SE (NYSE) ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Morningstar Analyst Forecasts

### Cash Flow (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	Forecast	
				2015	2016
Net Income	1,047	1,159	1,283	968	1,116
Depreciation	760	787	809	800	880
Amortization	—	—	—	—	—
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	210	421	388	462	504
Other Non-Cash Adjustments	-75	-121	19	—	—
(Increase) Decrease in Accounts Receivable	69	-94	-9	-85	-78
(Increase) Decrease in Inventory	80	17	-106	-40	-33
Change in Other Short-Term Assets	1	-88	-143	—	—
Increase (Decrease) in Accounts Payable	-51	-2	25	58	49
Change in Other Short-Term Liabilities	-103	-49	-45	—	—
<b>Cash From Operations</b>	<b>1,938</b>	<b>2,030</b>	<b>2,221</b>	<b>2,164</b>	<b>2,437</b>
(Capital Expenditures)	-2,025	-1,947	-2,028	-2,460	-2,800
Net (Acquisitions), Asset Sales, and Disposals	-30	-1,254	809	—	—
Net Sales (Purchases) of Investments	—	—	-783	—	—
Other Investing Cash Flows	-619	-35	-1	—	—
<b>Cash From Investing</b>	<b>-2,674</b>	<b>-3,236</b>	<b>-2,003</b>	<b>-2,460</b>	<b>-2,800</b>
Common Stock Issuance (or Repurchase)	527	214	—	3,000	1,000
Common Stock (Dividends)	-873	-821	-925	-996	-1,077
Short-Term Debt Issuance (or Retirement)	—	—	574	-1,583	—
Long-Term Debt Issuance (or Retirement)	975	2,233	-156	492	560
Other Financing Cash Flows	25	-310	308	-130	-150
<b>Cash From Financing</b>	<b>654</b>	<b>1,316</b>	<b>-199</b>	<b>783</b>	<b>333</b>
Exchange Rates, Discontinued Ops, etc. (net)	2	-3	-5	—	—
<b>Net Change in Cash</b>	<b>-80</b>	<b>107</b>	<b>14</b>	<b>486</b>	<b>-30</b>

# Spectra Energy Corp SE (NYSE) | ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Valuation Analysis

Company/Ticker	Price/Fair Value	Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	0.97	39.5	51.3	24.4	18.4	18.4	16.0	105.8	NM	37.6	2.6	2.6	2.6	5.5	5.0	4.3
Enbridge Inc ENB USA	0.98	17.4	21.2	16.7	19.2	18.9	15.0	NM	NM	NM	3.0	3.3	3.4	1.3	1.5	1.3
Williams Companies Inc WMB USA	0.90	15.4	69.5	57.1	10.1	13.1	10.9	NM	NM	NM	3.8	2.9	2.8	4.4	3.6	3.0
Average		24.1	47.3	32.7	15.9	16.8	14.0	105.8	—	37.6	3.1	2.9	2.9	3.7	3.4	2.9
<b>Spectra Energy Corp SE US</b>	<b>0.76</b>	<b>22.5</b>	<b>28.1</b>	<b>24.4</b>	<b>12.3</b>	<b>13.8</b>	<b>12.5</b>	<b>126.2</b>	<b>NM</b>	<b>NM</b>	<b>3.0</b>	<b>2.1</b>	<b>2.0</b>	<b>4.1</b>	<b>3.8</b>	<b>3.6</b>

### Returns Analysis

Company/Ticker	Last Historical Year Total Assets (Mil)	ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	83,198 USD	—	—	—	12.0	9.7	10.5	4.4	5.2	10.9	1.3	2.1	4.2	2.0	4.9	5.4
Enbridge Inc ENB USA	72,857 CAD	—	—	—	6.1	3.7	4.6	11.9	-0.8	6.5	1.7	-0.1	0.7	1.5	2.5	2.9
Williams Companies Inc WMB USA	50,563 USD	—	—	—	17.9	5.9	7.1	31.0	5.3	5.7	5.4	1.1	1.3	6.7	5.5	6.4
Average		—	—	—	12.0	6.4	7.4	15.8	3.2	7.7	2.8	1.0	2.1	3.4	4.3	4.9
<b>Spectra Energy Corp SE US</b>	<b>34,040 USD</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>11.0</b>	<b>8.9</b>	<b>9.2</b>	<b>13.0</b>	<b>8.8</b>	<b>8.4</b>	<b>3.2</b>	<b>2.4</b>	<b>2.6</b>	<b>3.8</b>	<b>4.2</b>	<b>4.6</b>

### Growth Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	16,226 USD	15.3	8.8	15.3	18.7	-5.6	13.0	89.4	-24.4	110.6	-143.6	-214.7	784.9	—	—	10.0
Enbridge Inc ENB USA	37,641 CAD	14.4	-9.4	14.1	134.4	-15.7	39.2	68.9	-24.0	27.0	81.4	-36.0	-45.7	11.1	11.7	11.7
Williams Companies Inc WMB USA	7,637 USD	11.3	31.4	17.3	184.2	-36.0	22.3	364.0	-76.5	22.2	333.0	-88.4	-26.0	116.4	-23.5	12.6
Average		13.7	10.3	15.6	112.4	-19.1	24.8	174.1	-41.6	53.3	90.3	-113.0	237.7	63.8	-5.9	11.4
<b>Spectra Energy Corp SE US</b>	<b>5,903 USD</b>	<b>7.0</b>	<b>6.3</b>	<b>5.5</b>	<b>4.9</b>	<b>-16.3</b>	<b>10.1</b>	<b>4.1</b>	<b>-22.7</b>	<b>15.3</b>	<b>-256.7</b>	<b>-91.2</b>	<b>-71.2</b>	<b>12.7</b>	<b>7.6</b>	<b>8.1</b>



# Spectra Energy Corp SE (NYSE) ★★★★★

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35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream

## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	1,213 USD	45.4	41.1	43.3	44.4	40.4	40.2	31.6	27.4	26.9	7.5	9.9	18.2	5.2	-5.2	11.6
Enbridge Inc ENB USA	2,490 CAD	21.7	26.9	30.3	12.7	14.5	16.2	8.5	7.9	9.7	6.6	5.6	6.3	-21.7	-16.4	-10.2
Williams Companies Inc WMB USA	2,114 USD	41.0	47.2	48.2	71.6	43.5	44.5	56.2	27.4	28.5	27.7	5.6	6.1	-25.1	-9.2	-4.8
Average		36.0	38.4	40.6	42.9	32.8	33.6	32.1	20.9	21.7	13.9	7.0	10.2	-13.9	-10.3	-1.1
<b>Spectra Energy Corp SE US</b>	<b>1,082 USD</b>	<b>46.2</b>	<b>43.0</b>	<b>40.9</b>	<b>53.4</b>	<b>44.0</b>	<b>45.9</b>	<b>39.7</b>	<b>31.3</b>	<b>32.6</b>	<b>18.3</b>	<b>13.4</b>	<b>14.6</b>	<b>3.3</b>	<b>-4.7</b>	<b>-5.5</b>

### Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	42,963 USD	126.1	140.0	143.9	55.8	58.3	59.0	4.0	3.4	5.9	6.0	6.6	6.1	2.4	2.6	2.6
Enbridge Inc ENB USA	36,239 CAD	215.9	264.8	314.8	68.3	72.6	75.9	4.2	2.1	2.3	7.6	8.4	7.7	4.3	5.0	5.6
Williams Companies Inc WMB USA	21,690 USD	247.1	169.6	183.7	71.2	62.9	64.8	7.3	4.0	4.3	4.0	4.8	4.5	5.8	4.3	4.4
Average		196.4	191.5	214.1	65.1	64.6	66.6	5.2	3.2	4.2	5.9	6.6	6.1	4.2	4.0	4.2
<b>Spectra Energy Corp SE US</b>	<b>14,352 USD</b>	<b>175.9</b>	<b>120.5</b>	<b>116.2</b>	<b>63.8</b>	<b>54.7</b>	<b>53.8</b>	<b>4.6</b>	<b>3.9</b>	<b>4.3</b>	<b>4.6</b>	<b>4.8</b>	<b>4.5</b>	<b>4.2</b>	<b>3.3</b>	<b>3.2</b>

### Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Kinder Morgan, Inc. KMI USA	88,461 USD	0.28	0.27	1.30	0.59	0.63	0.98	0.52	0.56	0.91	0.12	0.22	1.04	—	248.0	129.6
Enbridge Inc ENB USA	40,700 USD	1.56	0.13	1.28	0.86	0.64	0.68	0.74	0.53	0.58	0.46	0.03	0.36	106.1	NM	253.7
Williams Companies Inc WMB USA	35,847 USD	0.33	1.12	1.85	0.74	0.96	1.14	0.65	0.86	1.05	0.30	1.15	1.98	106.5	347.2	319.9
Average		0.72	0.51	1.48	0.73	0.74	0.93	0.64	0.65	0.85	0.29	0.47	1.13	106.3	297.6	234.4
<b>Spectra Energy Corp SE US</b>	<b>23,589 USD</b>	<b>0.32</b>	<b>1.04</b>	<b>1.00</b>	<b>0.61</b>	<b>1.29</b>	<b>1.30</b>	<b>0.53</b>	<b>1.13</b>	<b>1.13</b>	<b>0.14</b>	<b>—</b>	<b>—</b>	<b>85.4</b>	<b>118.9</b>	<b>111.5</b>

# Research Methodology for Valuing Companies

## Components of Our Methodology

- ▶ Economic Moat™ Rating
- ▶ Moat Trend™ Rating
- ▶ Moat Valuation
- ▶ Three-Stage Discounted Cash Flow
- ▶ Weighted Average Cost of Capital
- ▶ Fair Value Estimate
- ▶ Scenario Analysis
- ▶ Uncertainty Ratings
- ▶ Margin of Safety
- ▶ Consider Buying/Selling
- ▶ Stewardship Rating

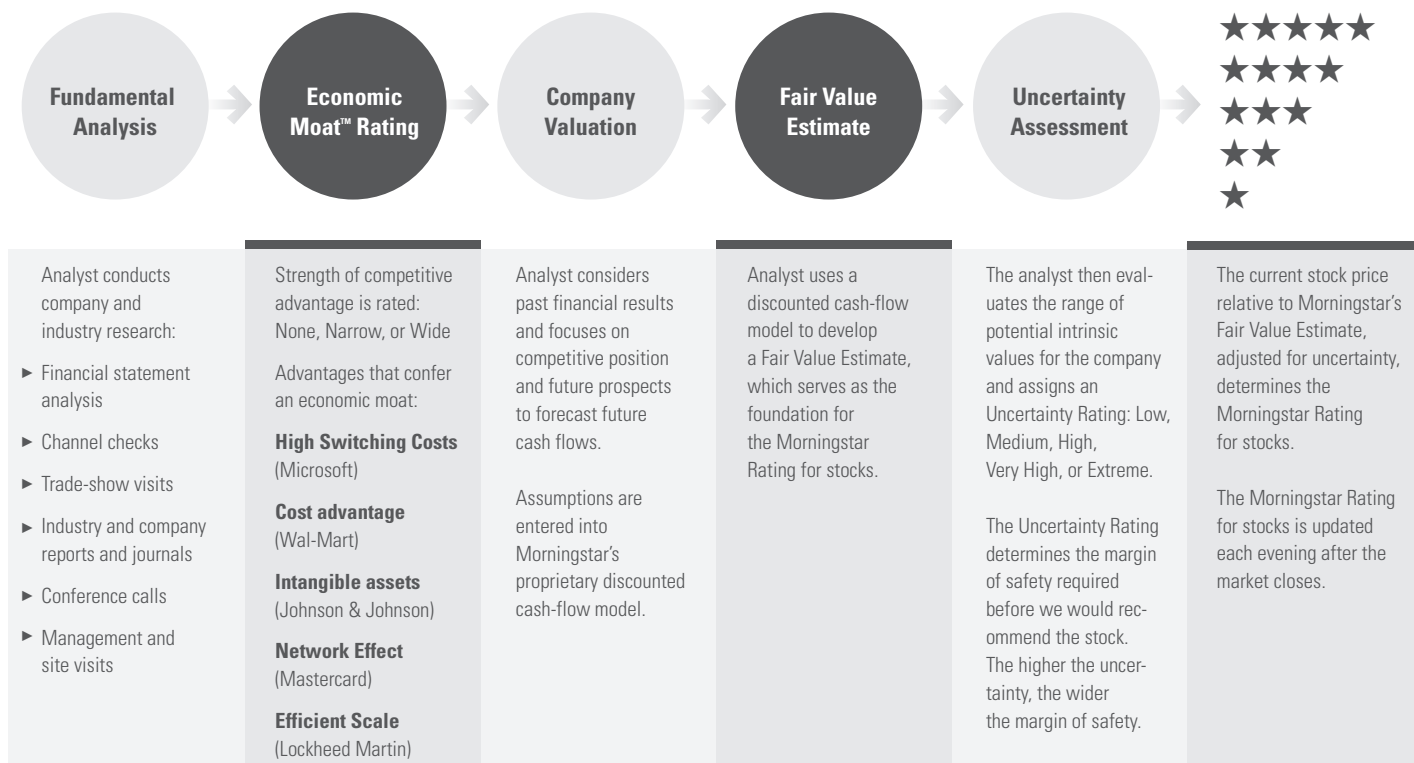
The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts’ assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm’s economic moat, (2) our estimate of the stock’s intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm’s investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm’s moat determine the length of “economic outperformance” that we assume in the latter stages

of our valuation model. We also quantify the value of each firm’s moat, which represents the difference between a firm’s enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm’s competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company’s future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm’s return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm’s RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

## Morningstar Research Methodology for Valuing Companies



# Research Methodology for Valuing Companies

## Detailed Methodology Documents and Materials\*

- ▶ Comprehensive Equity Research Methodology
- ▶ Uncertainty Methodology
- ▶ Cost of Equity Methodology
- ▶ Morningstar DCF Valuation Model
- ▶ Stewardship Rating Methodology

\* Please contact a sales representative for more information.

perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm’s underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm’s fixed cost structure.

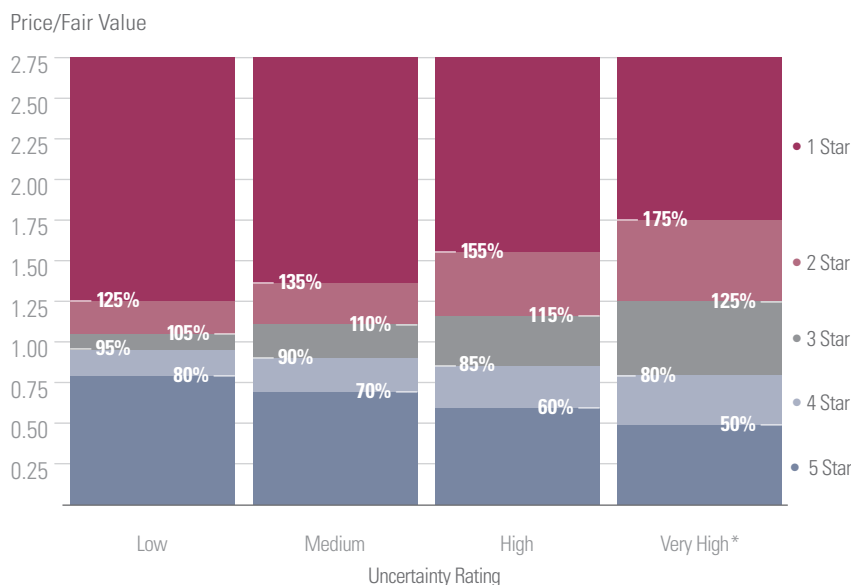
We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company’s future sales range, the firm’s operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium

to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management’s stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies’ investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they’ve had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder’s perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

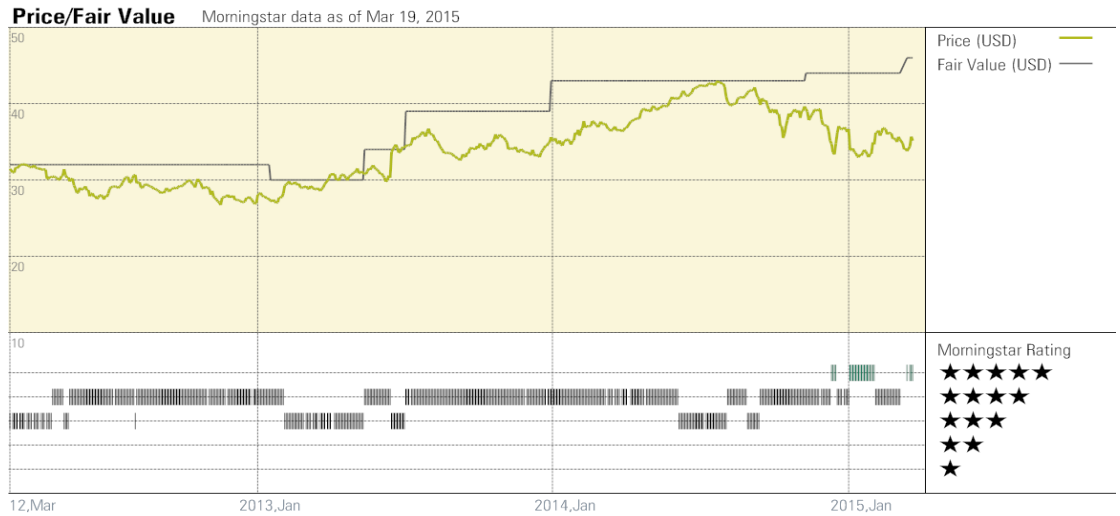
### Morningstar Margin of Safety and Star Rating Bands



\* Occasionally a stock’s uncertainty will be too high for us to estimate, in which case we label it Extreme.

# Spectra Energy Corp SE (NYSE) ★★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
35.15 USD	46.00 USD	36.80 USD	57.50 USD	Low	Wide	Stable	Exemplary	Oil & Gas - Midstream



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